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BEFORE THE ARIZONA CORPORATION COMMISSION

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TOM FORESE

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AZ CORP COMMISSION  
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IN THE MATTER OF THE JOINT  
APPLICATION OF WILLOW VALLEY  
WATER CO., INC. AND EPCOR WATER  
ARIZONA INC. FOR APPROVAL OF THE  
SALE OF ASSETS AND TRANSFER OF  
CERTIFICATE OF CONVENIENCE AND  
NECESSITY.

DOCKET NO. W-01732A-15-0131  
DOCKET NO. W-01303A-15-0131

**STAFF'S NOTICE OF FILING  
SURREBUTTAL TESTIMONY**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission")  
hereby files the Surrebittal Testimony of Staff witness Darron Carlson, in the above-captioned  
matter.

RESPECTFULLY SUBMITTED this 13<sup>th</sup> day of November, 2015.

*Robert Mitchell For:*

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ORIGINAL and thirteen (13) copies of the  
foregoing filed this 13<sup>th</sup> day of November, 2015,  
with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Arizona Corporation Commission

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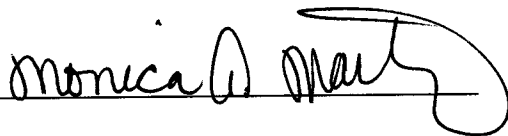
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

SUSAN BITTER SMITH

Chairman

BOB STUMP

Commissioner

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SURREBUTTAL

TESTIMONY

OF

DARRON CARLSON

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 13, 2015

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**EXECUTIVE SUMMARY**  
**WILLOW VALLEY WATER CO., INC. & EPCOR WATER ARIZONA, INC.**  
**DOCKET NOS. W-01732A-15-0131 & W-01303A-15-0131**

I am adopting the direct testimony of Gerald Becker as my own. I am filing surrebuttal testimony to 1) withdraw one of Staff's recommendations from direct testimony and 2) respond to the Applicants' various witness' rebuttal testimony.

Staff recommends:

1. That the Commission deny recognition of any acquisition premium that EPCOR Water Arizona, Inc. ("EWAZ") pays for Willow Valley Water Co., Inc. ("Willow Valley"),
2. That the Commission deny recognition of any acquisition adjustment or other premium to be applied to capital expenditures required in the ordinary course of business,
3. That EWAZ be put on notice that Willow Valley should work towards a balanced capital structure and that a hypothetical capital structure may be deemed appropriate in a future rate proceeding if EWAZ fails to do so,
4. That EWAZ shall continue to comply with all prior decisions, and more specifically the requirements of Decision No. 74364 which requires annual reporting of the Willow Valley water losses until such time as annual water losses are less than 10 percent.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Darron Carlson. My business address is 1200 West Washington Street, Phoenix,  
4 Arizona 85007.

5  
6 **Q. By whom are you employed and in what capacity?**

7 A. I am employed by the Utilities Division ("Staff") of the Arizona Corporation Commission  
8 ("ACC" or "Commission") as a Public Utilities Analyst Manager.

9  
10 **Q. How long have you been employed with the Utilities Division?**

11 A. I have been employed by the Utilities Division since September of 1991.  
12

13 **Q. Please describe your educational background and professional experience.**

14 A. I hold a Bachelor of Arts degree in both Accounting and Business Management from  
15 Northeastern Illinois University in Chicago, Illinois.

16  
17 I have participated in quite a number of seminars and workshops related to utility rate-  
18 making, cost of capital, income taxes, and similar issues. These have been sponsored by  
19 organizations such as the National Association of Regulatory Utility Commissioners  
20 ("NARUC"), Duke University, Florida State University, Michigan State University, New  
21 Mexico State University, and various other organizations.

22  
23 **Q. Briefly describe your responsibilities as a Public Utilities Analyst Manager.**

24 A. In my capacity as a Public Utilities Analyst Manager, I supervise analysts who examine, verify,  
25 and analyze utilities' statistical, financial, and other information. These analysts write reports  
26 and/or testimonies analyzing proposed mergers, acquisitions, asset sales, financings, rate

1 cases, and other matters in which they make recommendations to the Commission. I provide  
2 support and guidance along with reviewing and editing the work products. I also perform  
3 analysis as needed on special projects. Additionally, I provide expert testimony at formal  
4 hearings. Finally, I assist Staff members during formal hearings and supervise responsive  
5 testimonies, as needed, during the hearing process.

6  
7 **PURPOSE OF TESTIMONY**

8 **Q. What is the scope of your testimony in this case?**

9 A. I am adopting the direct testimony of Staff witness, Gerald Becker, as my own. In addition,  
10 in my surrebuttal testimony, I withdraw one of Staff's recommendations in Staff's direct  
11 testimony. Further, I respond where necessary, to the rebuttal testimonies filed by Ron  
12 Fleming and Paul Walker on behalf of Willow Valley Water Co., Inc. ("Willow Valley") and  
13 Shawn Bradford and Sarah Mahler on behalf of EPCOR Water Arizona Inc. ("EWAZ")  
14 (collectively, the "Applicants"). I am also presenting Staff's revised recommendations  
15 regarding the transfer of Willow Valley to EWAZ.

16  
17 **Q. Do you attempt to address every issue raised by the Applicant's various witnesses in  
18 its rebuttal testimonies?**

19 A. No. My silence on any particular issue raised in the Applicant's rebuttal testimonies does not  
20 indicate that Staff agrees with the Applicant's rebuttal position on that issue. Rather, I rely on  
21 my direct testimony unless modified by this surrebuttal testimony.

22  
23 **SUMMARY OF RECOMMENDATIONS**

24 **Q. Please summarize Staff's recommendations.**

25 A. Staff recommends approval of the transfer subject to certain conditions which Staff believes  
26 to be in the public interest. These conditions include:

- 1           1.     That the Commission deny recognition of any acquisition premium that EWAZ pays
- 2                 for Willow Valley,
- 3           2.     That the Commission deny recognition of any acquisition adjustment or other
- 4                 premium to be applied to capital expenditures required in the ordinary course of
- 5                 business,
- 6           3.     That EWAZ be put on notice that Willow Valley should work towards a balanced
- 7                 capital structure and that a hypothetical capital structure may be deemed appropriate
- 8                 in a future rate proceeding if EWAZ fails to do so,
- 9           4.     That EWAZ shall continue to comply with all decisions, and more specifically the
- 10                requirements of Decision No. 74364 which requires annual reporting of the Willow
- 11                Valley water losses until such time as annual water losses are less than 10 percent.

12  
13   **Q.     How do the above recommendations compare to the recommendations reflected in**  
14   **Staff's direct testimony?**

15   A.    The recommendations listed above are virtually identical to the recommendations reflected in  
16   Staff's direct testimony except that Staff had listed six recommendations in its direct  
17   testimony and has withdrawn two (originally listed as number 3 and 5 in direct testimony) in  
18   its surrebuttal testimony. Recommendation 3 concerning SIB was addressed by the  
19   Commission in the interim of filing Staff direct and surrebuttal testimonies.

20  
21   **Q.     Why has Staff withdrawn recommendation 5?**

22   A.    This recommendation was in regard to the creation of a regulatory liability (chargeable to  
23   EWAZ) to replace the accumulated deferred income taxes that serve to reduce rate base that  
24   will disappear in the sales transaction. This will have the effect of increasing the rate base by  
25   approximately \$260,000 after the sales transaction is completed. Staff believed that creating  
26   the liability would leave the rate payers whole and unaffected by the sales transaction.



1     **Q.     Then why does Staff now want to withdraw the recommendation?**

2     A.     Staff has now concluded that this type of regulatory action may be inconsistent with the  
3           Internal Revenue Service's Normalization rules. If the Commission were to approve the  
4           regulatory liability, EWAZ could find itself out of compliance with the Normalization rule  
5           and could lose its ability to claim accelerated depreciation in the future on all of its  
6           depreciable utility plant in Arizona. This could present a very serious situation for EWAZ  
7           and all of its ratepayers in Arizona.

8

9     **RESPONSE TO REBUTTAL TESTIMONIES**

10    **Q.     Have you reviewed the rebuttal testimony of Willow Valley witness, Ron Fleming?**

11    A.     Yes I have. The only comments I have are that it appears that Global (Willow Valley's  
12           current parent) will likely suffer a capital loss on this sales transaction. Further, the extensive  
13           efforts put forward by Global would indicate that Willow Valley while needing a lot of  
14           refurbishment is certainly not a "distressed" utility. That is to say Global can fund and make  
15           improvements                   and                   properly                   operate                   the                   system.

16

17    **Q.     Have you reviewed the rebuttal testimony of Willow Valley witness, Paul Walker?**

18    A.     Yes I have. While Mr. Walker is generally correct in his academic discussion of utility  
19           consolidation, the fact is most consolidations (much like this transfer of assets) involve viable  
20           and usually well-funded water or wastewater utilities. Staff of the Commission have  
21           encouraged consolidation of small, distressed water and wastewater utilities. The ones with  
22           20, 50, or 100 ratepayers – we have a lot of them in Arizona. Unfortunately, it is very difficult  
23           for an operator to acquire and make such small utilities profitable. These are the ones that  
24           Staff stands ready to consider premiums and other incentives for, but Staff has not noted a  
25           great deal of interest in consolidating healthy utilities with these troubled utilities.

26    **Q.     Have you reviewed the rebuttal testimony of EWAZ witness, Shawn Bradford?**

1 A. Yes I have. While Staff appreciates the difficulties that can be encountered in running a  
2 utility with vast maintenance needs, Staff believes that ratepayers are none-the-less entitled to  
3 receive safe and reliable service. If systems are poorly maintained, problems can pile up, all  
4 while the ratepayers are arguably providing funding to support safe and reliable operations.  
5 Staff believes that acquisition premiums and acquisition related incentives should be  
6 considered in situations where corrective action may require assistance and/or financial  
7 support from a healthier or financially stronger acquiring utility. However, Staff believes it is  
8 not in the public interest to provide acquisition related incentives to new utility operators who  
9 are really committing to bringing the utility services up to standards that should have been  
10 maintained all along.

11  
12 **Q. Have you reviewed the rebuttal testimony of EWAZ witness, Sarah Mahler?**

13 A. Yes I have. Staff notes that Ms. Mahler seeks approval of incentives for investing capital in  
14 Willow Valley. Staff does not agree that incentives are necessary for a viable utility purchase.  
15 Willow Valley is viable. Staff does not agree with labeling Willow Valley a “troubled” utility.  
16 Staff has already explained above what it believes qualifies for incentives and Staff does not  
17 believe that Willow Valley falls within that description.  
18 Staff finds that Global did need outside funding to invest \$3.3 million into the Willow Valley  
19 system, as this outstrips the depreciation expense provided by ratepayers for the periods 2006  
20 to 2015. However, Staff notes that EWAZ promises expenditures of \$1 million over 5 years  
21 after acquisition, but the current rates include \$285,500 annually in depreciation expense from  
22 ratepayers. So ratepayers will provide \$1.4 million in funding from depreciation expense in  
23 those 5 years. Staff notes that EWAZ will control how that non-cash expense is expended.  
24 Further, Staff notes that the tax savings provided by the use of accelerated depreciation is  
25 another avenue for funding plant replacements and EWAZ will be beginning new  
26 depreciation on all of the Willow Valley plant assets it acquires. So, there are already

1 incentives in place that make this purchase attractive to EWAZ without making ratepayers  
2 pay more for equivalent services. The return of EWAZ's investment is sought as a premium  
3 for its investment. However, Staff notes that EWAZ receives its return on investment via  
4 depreciation expense and a return on its investment via a rate of return on rate base.  
5

6 **RECOMMENDATIONS**

7 **Q. Based on the above, what is Staff recommending?**

8 **A.** Staff recommends approval of the transaction subject to the following conditions:

- 9 1. That the Commission deny recognition of any acquisition premium that EWAZ pays  
10 for Willow Valley,
- 11 2. That the Commission deny recognition of any acquisition adjustment or other  
12 premium to be applied to expenditures required in the ordinary course of business,
- 13 3. That EWAZ be put on notice that Willow Valley should work towards a balanced  
14 capital structure and that a hypothetical capital structure may be deemed appropriate  
15 in a future rate proceeding if EWAZ fails to do so,
- 16 4. That EWAZ shall continue to comply with all decisions, and more specifically the  
17 requirements of Decision No. 74364 which requires annual reporting of the Willow  
18 Valley water losses until such time as annual water losses are less than 10 percent.  
19

20 **Q. Does this conclude your surrebuttal testimony?**

21 **A.** Yes, it does.